جدوى للإستثمار
Jadwa Investment

April 2016

The Saudi Stock Exchange (Tadawul) in 2016

Summary

- The Tadawul All Share Index (TASI) has dropped dramatically since mid-2015, making it one of the worst performing equity markets amongst major global and regional indices. Whilst the decline in oil prices has been an obvious factor in this fall, a number of other developments have played their part in dampening investor sentiment.

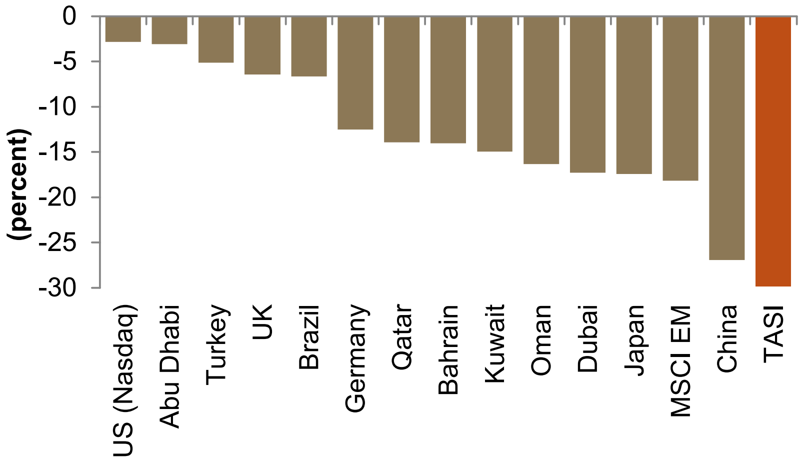
- In general, a deteriorating outlook over Chinese economic growth led to a reversal of portfolio equity flows from emerging markets. More specifically, the TASI suffered due to an escalation in regional political upheaval and energy price reform, whilst an overreaction by retail investors with short term investment horizons added to declines.

- The above factors have also contributed to a slow take-up by Qualified Foreign Investors (QFIs) since the TASI opened up in July 2015, but as we have noted on previous occasions, the risks of over pricing of stocks in the short to medium term also discouraged initial QFI entry.

- In recent weeks we have seen some tentative signs of recovery in the TASI. A mild improvement in oil prices and stability in global equity markets has afforded us an opportunity to be cautiously optimistic as we move forward.

- Most sectors have seen profitability decline in line with tougher macroeconomic conditions and whilst profitability will be challenged further, some sectors, such as Banking and Agriculture & Food, are expected to remain resilient despite challenging market conditions.

Figure 1: TASI vs major global and regional indices since mid-2015*



*Note: Performance until 7th March 2016

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Recent TASI Performance

The Saudi Stock Exchange (Tadawul) has dropped dramatically since mid-2015…

The Saudi Stock Exchange (Tadawul) has dropped dramatically since mid-2015, from around 9,000 to reach lows of 5,500 points in January, making it one of the worst performing equity markets amongst major global and regional indices (Figure 1). Whilst the decline in oil prices has been an obvious factor in this fall, a number of other developments have played their part in dampening investor sentiment in the Tadawul All Share Index (TASI).

…with a number of factors dampening investor sentiment.

Global context:

The steep decline in the TASI since 2015 has to be viewed in the context of a general pattern…

The steep decline in the TASI since 2015 has to be viewed in the context of a general pattern of emerging market (EM's) portfolio equity flows. During 2015 there were widespread expectations of a rise in interest rates from the US Federal Reserve (Fed). Conventional economic theory follows that low US interest rates push capital and equity towards higher yielding EM's, whilst higher US interest rates reduce these flows. Concurrently, global investor sentiment towards EM's became increasingly bearish as concerns over China's economic growth deepened drastically in August 2015. The combination of the above two factors led to a reversal of portfolio equity flows from EM's after mid-2015 (Figure 2).

…one which saw a reversal of portfolio equity flows from EM's from mid-2015 onwards.

China, oil prices and the TASI:

In August 2015, the Central Bank of China (PBoC) carried out three consecutive devaluations of the yuan currency, pushing it down by 3 percent relative to the US dollar. The devaluation was the largest single drop in over 20 years and was perceived as an attempt to boost exports in a bid to support the economy. This also led to Brent falling by 18 percent during the month. The yuan was allowed to devalue a further 0.8 percent in January 2016, which partly contributed to Brent dropping by 19 percent in the month as well. We can see that worsening sentiment over Chinese economic growth, linked to a weaker yuan, led to additional pressure on already beleaguered oil prices in both August 2015 and January 2016. Since China represents one of Saudi Arabia's largest export markets for both crude oil and petrochemicals, the knock-on effect on the TASI was swift and considerable (Figure 3).

Worsening sentiment over Chinese economic growth had a knock-on effect on the TASI.

Figure 2: Net non-resident purchases of EM stocks negative since mid-2015.

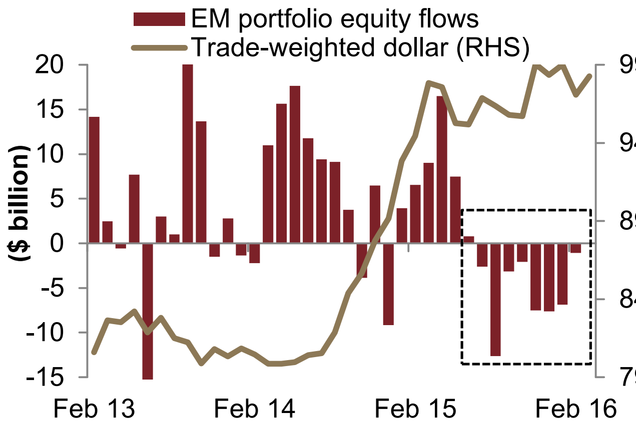
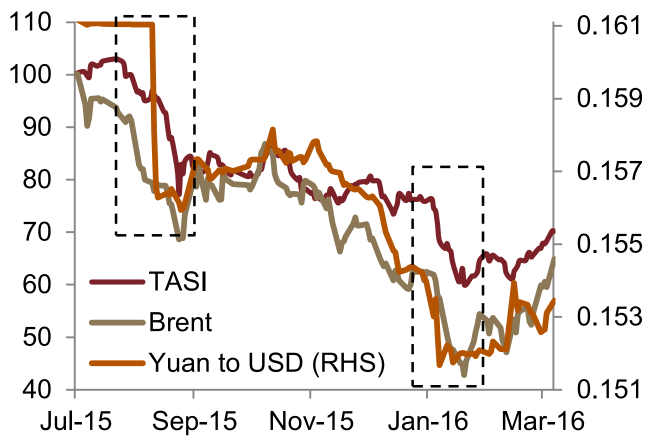


Figure 3: TASI, Brent and the Chinese yuan's performance since mid-2015*



*Note: TASI and Brent rebased to 100 at 1st July 2015

More Than Just About Oil?

But the TASI's performance was the poorest even amongst major oil exporting countries indices.

We believe this was due to:

Linking the decline of the TASI to China and oil prices, however, only explains part of the story. We can see that since mid-2015 as concerns over China's slowdown became more apparent most major oil exporting indices were severely impacted, with the TASI still performing the worst (Figure 4). We believe the more severe decline in the TASI was a result of:

<u>Heightened regional geopolitical tensions:</u>

An escalation in regional political upheaval…

...with Syria, Iraq, Libya and Yemen all suffering from long running complicated civil conflicts...

...but a glut in global oil markets has led to an absence of a risk premium attached to oil prices…

...meaning a lack of support for both the sovereign and external positions of Saudi Arabia, contrary to cases in the past.

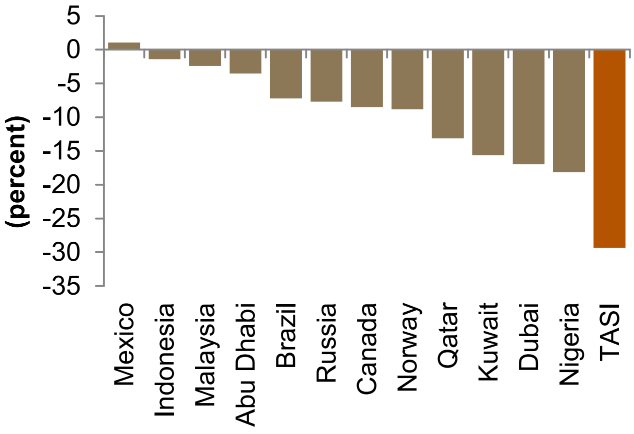
Last year witnessed an escalation in regional political upheaval which contributed to dampening investor sentiment towards not only the TASI but regional indices too. Modern post-war history has been marked by frequent and intense conflict within the region, but even by historical standards, the current geopolitical situation is quite severe. Syria, Iraq, Libya and Yemen are suffering from long running complicated civil conflicts. To add to this, Tunisia, Egypt and Turkey have been targeted by terrorist organizations in high profile attacks, underlining the security challenges facing the region. Under normal circumstances, in instances where regional political uncertainty negatively effects investor confidence, we would expect there to be an increase in the risk premium attached to oil prices since the region is a major supplier of crude oil. The resulting higher oil price would, in turn, support both the sovereign and external positions of Saudi Arabia and other Gulf countries, ultimately having a positive impact on the stock market, something akin to what we saw happen around 2011 during the so-called 'Arab Spring'. However, the current period of heighted regional conflict is different since it coincides with a glut in the global oil market, with elevated levels of output seen from a number of producers plus record levels of commercial crude stockpiling. Therefore, even with a higher level of regional geopolitical tension the absence of a risk premium attached to oil prices suggests that the market believes there is more than enough oil washing around to react to any adverse supply shock in the short-term (Figure 5).

<u>Lack of policy clarity adding to market uncertainty:</u>

Lack of policy clarity added to market uncertainty…

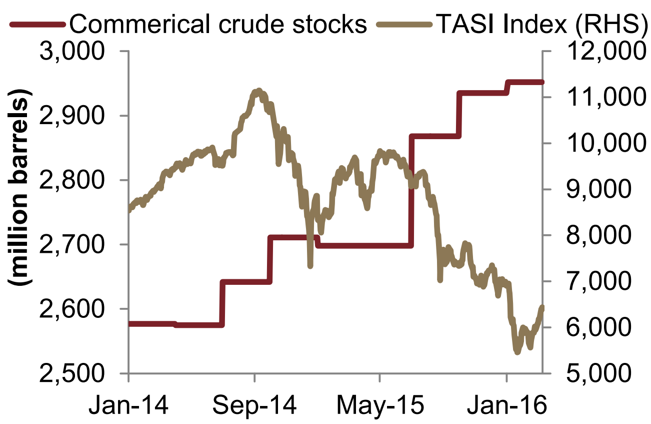
As we stated in previous reports, one of the key components in nurturing sophisticated and smooth functioning stock markets should include having the availability of timely and consistent data and

Figure 4: TASI vs. major oil producing countries' indices since mid-2015*



*Note: Performance until 7th March 2016

Figure 5: TASI and OECD commercial crude stocks



...whilst we expect the NTP to clarify economic reforms…

...there has been no clear official communication as to when exactly it will be published.

information. Whilst we have seen clear evidence of efforts to improve reporting standards from public and private bodies in the dissemination of relevant data, what seems to be missing, so far, is clearer guidance on macro-level economic policy. A number of major decisions have either been implemented or planned ,hitherto, without sufficient official communication. One example is the swift manner in which the rise in energy prices was implemented. The period between announcing increases in energy prices and implementing the price rises was extremely short. Whilst Jadwa believes that an effective reform program can add significant welfare gains to the Saudi economy, a lack of clarity and detail on the precise timing and nature of future price hikes, if any, can add to market uncertainty. Similarly, whilst we expect a number of economic reforms to be clarified in the National Transformation Plan (NTP) there has been no clear official communication as to when exactly the NTP will be published.

Market Turnover

Investors seem to have taken a cautious approach leading to monthly turnover in the TASI declining…

...which has coincided with a sharp rise in speculative activity in certain smaller sectors.

The lack of policy clarity, to date, combined with the backdrop of lower oil prices, EM portfolio outflows, and heightened regional geopolitical tension has contributed to driving down monthly turnover in the TASI. Investors seem to have taken a cautious approach as key decisions relating to the future of the Saudi economy have yet to be fully outlined. Value of traded volumes averaged SR8.2 billion in the year to June 2015, but dropped by 37 percent in the period between July 2015 to February 2016, to SR5.2 billion (Figure 6).The recently observed lower value of traded volumes has coincided with a sharp rise in speculative activity in certain smaller sectors, specifically the media sector. Whilst there has been some positive news related to the sector it does not justify the exceptionally high value of traded volumes seen in the second half of 2015 (Figure 7). Retail investors look to make shorter term profits by focusing on smaller sectors in the stock market, which are more susceptible to price movements. The patterns observed in the media sector are indicative of this, with a raised value in traded volumes directly a result of speculative trading in the backdrop of a declining market.

Qualified Foreign Investors (QFIs)

Latest data shows that in the eight months to February 2016, net inflow from qualified foreign investors (QFIs) amounted to SR784

Figure 6: Average value of traded volumes lower since mid-2015

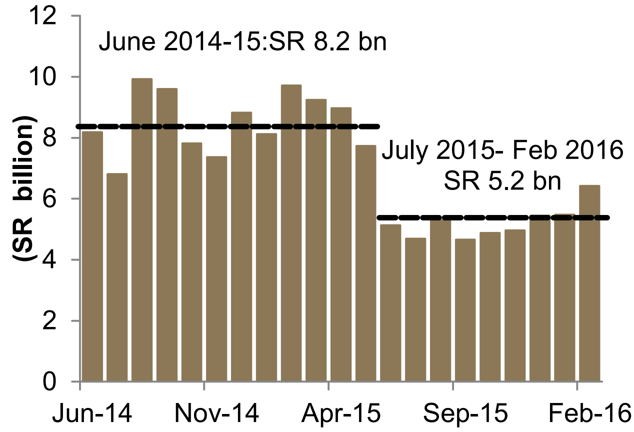
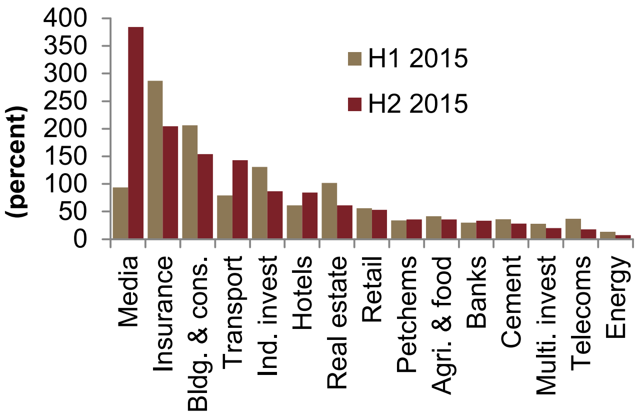


Figure 7: Value of traded volume as percent of market cap elevated amongst smaller sectors



Latest data shows net inflow from QFIs amounted to SR784 mn since the opening of the TASI.

million, equivalent to 0.1 percent of market capitalization of SR1.4 trillion in March 2016 (Figure 8). Considering the developments outlined in the previous sections, it is unsurprising that there has been a slow take-up by QFIs since the TASI opened up in July 2015. Additionally, we believe the slow take-up has been exacerbated by something which we foresaw a while back.

With the TASI being relatively expensive, up until recently, this has led QFIs to wait it out before entering the market.

In our *Saudi Stock Market* report (published August 2014) we noted that the opening of the Tadawul raised the risks of over pricing of stocks in the short to medium term which could discourage QFI entry initially. With the greater dominance of retail investors and their higher risk tolerance, we saw a strong possibility that the TASI could move beyond fair value levels. Looking at historical price-to-earnings (PE) valuations, we can see PE rose quite rapidly beyond long-term averages on two separate occasions, only to be re-priced downwards quite swiftly as other developments, notably lower prices and poorer listed company quarterly results, unfolded. Both instances of rising PE levels occurred around announcements relating to the opening up of the Saudi Stock Exchange, in July 2014 and again in April 2015 (Figure 9). With the TASI being relatively expensive compared to many global and regional indices up until recently, we believe this has led QFIs to wait until valuations have cooled, or bottomed, before entering the market, all aforementioned non-financial factors considered.

Sell-Off Over Done

The dominance of retail investors has fueled an irrational overreaction…

...leading to the TASI being oversold...

...but this does not correlate with the sound macroeconomic fundamentals of Saudi Arabia.

Just as the TASI over shot fair values for short periods in the past, we feel the reverse is also true for the steep losses occurred by TASI since mid-2015. The dominance of retail investors has fueled an irrational overreaction, which does not correlate with the sound macroeconomic fundamentals of Saudi Arabia. The 2016 budget outlined only a small reduction in year-on-year spending, by SR20 billion, to a total of SR840 billion. Although this will result in a second consecutive fiscal deficit of SR326 billion, it underscores the government's determination and ability to support economic activity through an elevated level of spending. In addition, the Kingdom still enjoys ample pool of foreign reserves, at $584 billion, and has the financial capacity to issue debt, which it has been doing since June 2015. Overall, the combination of short term investment horizons of retail investors and the various above stated factors have contributed to the TASI being oversold.

Figure 8: Net purchases/sales by QFIs

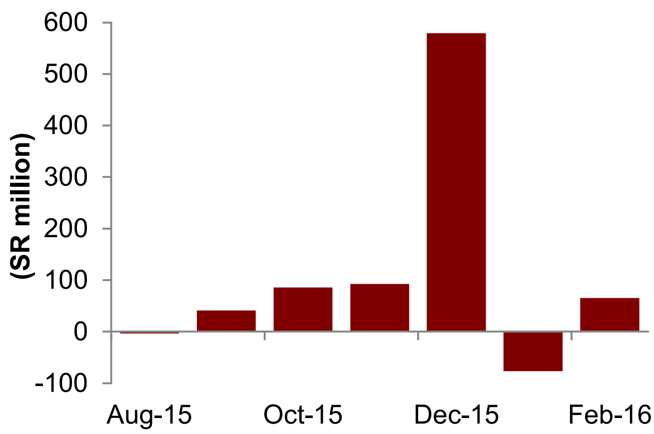
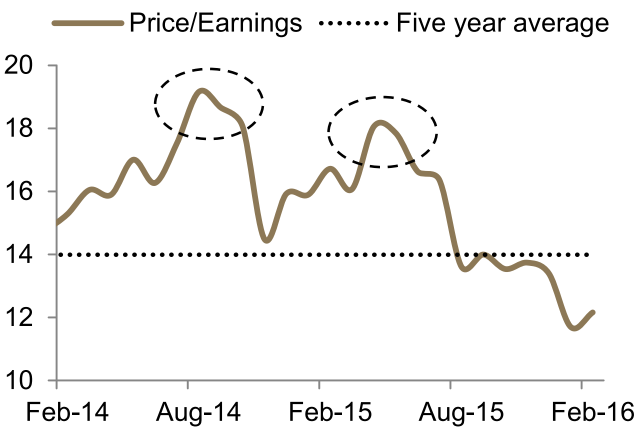


Figure 9: TASI price-to-earnings ratio



Performance and Outlook of Major Sectors

The petrochemical and banking sectors have accounted for a significant portion of total net income of listed companies.

In 2015 the petrochemical sector's net income declined by 38 percent year-on-year.

This was due to a narrowing of its cost advantage on two fronts…

...European and Asian producers of ethylene benefitted from lower priced oil-derived naphtha feedstock…

...whilst the 2016 Saudi budget included price rises for the prominent petrochemical feedstock ethane...

Most sectors have seen profitability decline in line with challenging conditions. Overall, lower oil prices and tighter public spending led to declining profitability and deterioration of investor sentiment (Figure 10).

Historically, the petrochemical and banking sectors together have accounted for a significant portion of total net income of listed companies. In 2015, the two sectors experienced diverging profitability, with the petrochemical sector's net income declining by 38 percent year-on-year but banks registering a growth of 5 percent year-on-year. As a consequence, in Q4 2015, banks accounted for a sizable 54 percent of total TASI listed net income, up from 38 percent in Q1 2014, making it the largest single contributor to overall profits (Figure 11).

Petrochemicals:

One key factor behind the petrochemical sector's drop in profitability and performance has been a narrowing of its cost advantage on two fronts in the production of ethylene, the largest globally produced petrochemical. Firstly, European and Asian producers of ethylene have benefitted on the back of lower priced oil-derived naphtha feedstock and, secondly, a hike in the price of petrochemical feedstock in the Kingdom has increased the cost base for Saudi petrochemical companies.

The 2016 Saudi budget included price increases for domestic energy inputs, including the prominent petrochemical feedstock ethane. Saudi Arabia's largest feedstock is now fixed at a price of $1.75 per million British thermal units (mmBtu) up from $0.75 mmBtu previously. The pricing formula for other lesser used feedstock, namely liquid petroleum gases (LPGs) was also changed (Table 1).

In July 2015, prior to the feedstock price hike and when Brent averaged $57 per barrel, Saudi petrochemical companies enjoyed a near $587 per ton cash cost advantage in the production of a ton of ethylene against Asian producers. In January 2016, with higher feedstock prices and Brent prices averaging $31 pb, this advantage narrowed to $382 per ton. As we noted in our report titled *Oil prices and the Saudi Stock Exchange* (published June 2015), since the petrochemical sector has a larger weighting, in terms of market

Figure 10: Quarterly net income of TASI listed companies and Brent oil price

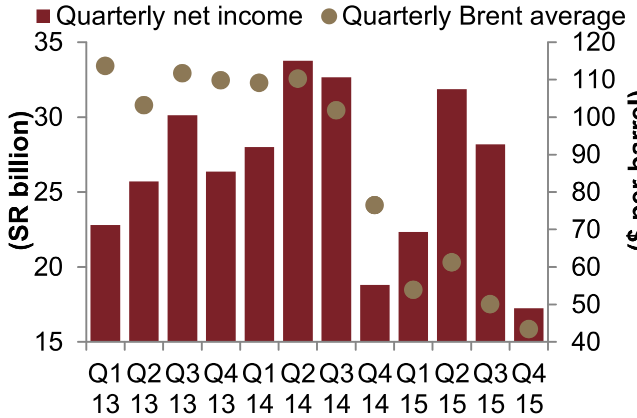
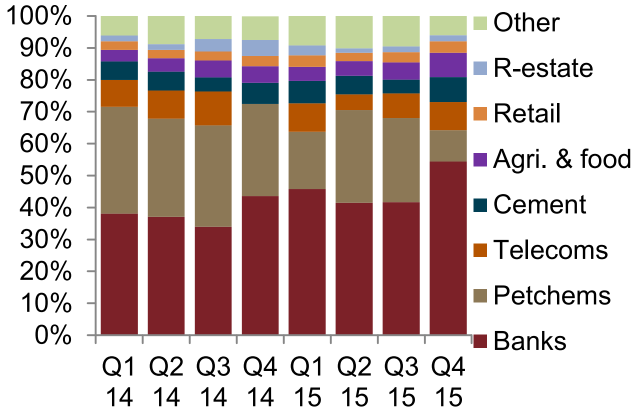


Figure 11: Major contributors to TASI net income*



*Note: Energy sector excluded

...all of which has affected profitability and which has been felt more prominently by the TASI as a whole.

capitalization and net-income, versus most other sectors in the TASI, any changes to petrochemical profitability and performance are felt more prominently within the TASI as a whole (Figure 12).

Table 1: Saudi Petrochemical Feedstock Prices

	Old price	New price
Ethane ($mmBtu)	0.75	1.75
Methane ($mmBtu)	0.75	1.25
Propane	28% discount to Japanese Naphtha*	20% discount to Japanese Propane*
Butane	28% discount to Japanese Naphtha*	20% discount to Japanese Butane*

Source: Saudi Press Agency and Jadwa Investment
*Note: Excluding the cost of freight and insurance from Ras Tanura to Japan

Aside from higher feedstock prices the sector is facing rising levels of international competition…

Aside from higher feedstock prices, the sector is also facing up to a slew of global projects coming on-line during 2016, especially from China, which is a major importer of Saudi (and GCC) petrochemical products. Saudi exports are likely to face competition from additional domestic Chinese coal-to-olefins and methanol-to-olefins capacity coming on-line and slower Chinese economic growth will add further pressure on demand for petrochemicals.

...including potentially higher Iranian exports of petrochemicals following the lifting of sanctions.

In addition, there is scope for potentially higher Iranian exports of petrochemicals following the lifting of sanctions. According to Iran's National Petrochemical Company (NPC), annual petrochemical production totaled 45 million tons (mt) in 2014 compared to Saudi production of 87 mt. If plans to double capacity by 2021 are fully implemented, Iran would have the largest capacity in the region, although significant barriers to attracting investment remain.

Banking:

The banking sector continued to perform strongly despite challenging macro-economic developments.

The banking sector has continued to perform strongly despite challenging macro-economic developments, partly as a result of rising interest rates. In December 2015, SAMA raised its key policy reverse repo rate (RRR) from 0.25 percent to 0.5 percent for the first time since 2009, mirroring a rise by the US Federal Reserve (Fed), in line with the Kingdom's policy of pegging the Saudi riyal to the US dollar. Due to the fact that Saudi banks generally have a high ratio of non-interest bearing deposits, any rise in interest rates allows for a significant pass-through to profits.

Figure 12: TASI and petrochemical sector quarterly net income

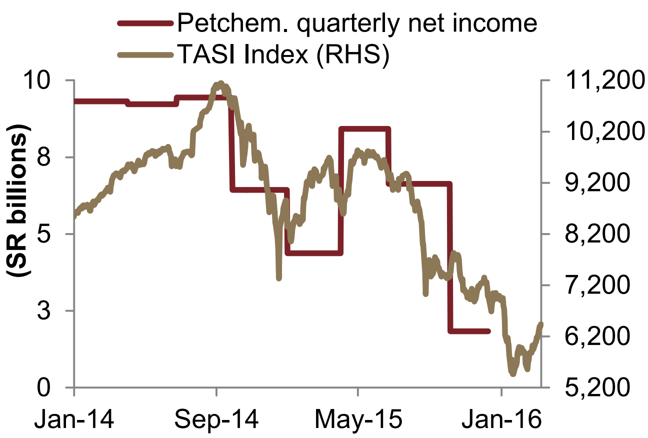
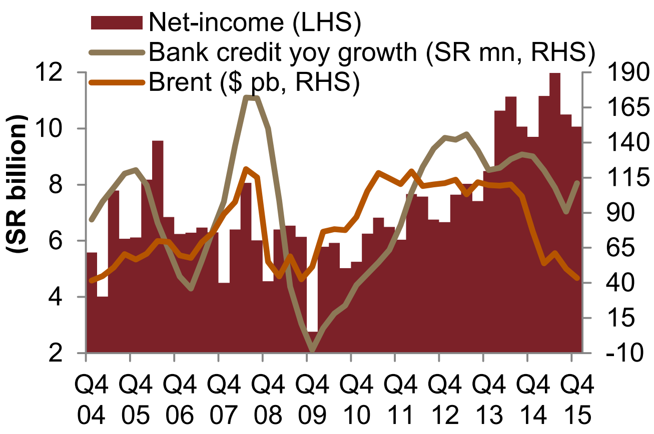


Figure 13: Banking sector net-income remained strong in 2015 despite slower credit growth



Investor sentiment towards the sector will be shaped by two key concerns, liquidity and credit quality.

Looking ahead, investor sentiment towards the banking sector will continue to be shaped by two key concerns, liquidity and credit quality. During the second half of 2015, banks significantly reduced their holdings of SAMA bills in order to free up liquidity for the purchase of the newly issued government bonds. Sovereign debt issuance to domestic banks, rose on a net basis by SR32 billion during the second half of 2015. Although we believe there is sufficient liquidity for banks to continue extending credit to the private sector, the notable rise in inter-bank rates (SAIBOR) since mid-2015, even prior to the RRR increase, and a precautionary rise in bank provisions in 2015, in anticipation of potential increases in non-performing loans, may point to a lesser willingness to lend. Whilst the recent rise in interest rates has helped prop up profits, even as credit growth has slowed, (Figure 13) the current context of lower oil prices and tighter government spending, plus further rises in Fed rates during 2016, will mean credit growth to private sector will slow, adding downward pressure to profitability. Early 2016 indicators do point to this lower trend. As we highlighted in our [Monetary and Financial Update]() (published March 2016), banks posted negative year-on-year growth in profits for the their first time since April 2013.

Lower oil prices, tighter government spending, plus further rises in Fed rates will see credit growth slow.

Despite this, we still see some bright spots for the sector, with one potential area of growth being residential lending. Although net new residential loans for real estate were down by 68 percent year-on-year during 2015, to SR7.7 billion. We see this as a result regulatory changes being applied throughout last year, rather than any reorientation of credit towards corporations. More recent amendments to credit rules by SAMA have made it slightly easier for borrowers to take out loans and less riskier for lenders. Borrowers are now only required to make a down payment of 15 percent rather than 30 percent previously, with Ministry of Finance (MoF) guaranteeing the other 15 percent. When banks adopt these new regulations during the course of 2016, lending activity in the residential segment will rise, especially as the supply of residential units increases too, thereby supporting profitability in the sector.

Despite this we still see some bright spots in the sector, most notably growth in residential lending.

<u>Telecoms:</u>

Whilst the telecom sector faces challenges there are some favorable factors which should help spur profitability. Overall, the key market of mobile service subscriptions seems to have hit maturity, as penetration rates have hovered around 170 percent for the last few years (Figure 14). The key to unlocking more revenue in this

Overall, the key market of mobile service subscriptions seems to have hit maturity.

Figure 14: Mobile phone subscriptions by type and penetration rates

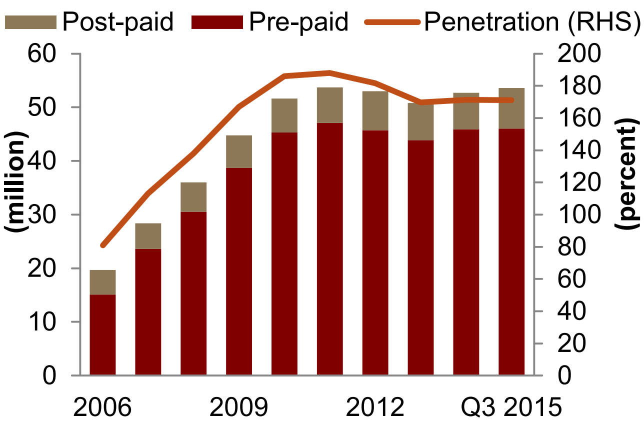
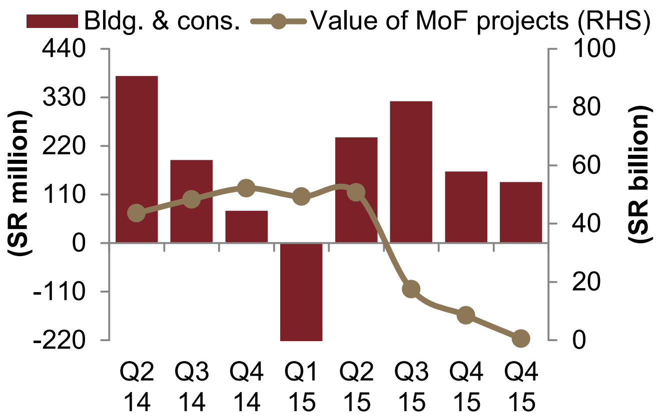


Figure 15: Building & construction net income and value of contracts approved by the MoF



saturated segment will rely on transferring more pre-paid customers towards post-paid contracts. Not only do post-paid customers lock in future revenue, through fixed contracts, they also exhibit a higher level of average revenue per unit and allow for easier cross-selling of other products. Post-paid customers currently only make up 17 percent of the total mobile subscription base, which presents a good source of potential additional revenue, but it will not come easy. In order to secure such customers, telecom companies will have to ensure differentiated and innovative products in a fast evolving segment with an increasingly sophisticated customer base. In a bid to lure customers intensive competition may materialize, resulting in less scope to increase tariffs for existing customers, pressuring operating margins in the short term.

One challenge for the sector is to transfer pre-paid customers to post -paid contracts.

Telecoms should also benefit from favorable structural factors in both the mobile and fixed broadband segments. Penetration rates in the fixed broadband are lower in the Kingdom than other GCC countries, at 53 percent in Q3 2015, compared to Oman, 70 percent and Bahrain, 91 percent, so this presents an obvious growth area.

Telecoms should also benefit from favorable factors in the mobile and fixed broadband segment.

Construction, Real Estate and Cement:

The decline in oil prices and resulting decline in approved construction contracts by the MoF have contributed to highly volatile profit levels in the building and construction sector (Figure 15). The adjustment in the sector was much harder in 2014 and whilst profitability recovered and stabilized in 2015, net-income has trended slowly downwards during the year, with the final quarter of 2015 being affected by a sharp reduction in the value of contracts being approved by MoF. Although stabilization in profits following cost cuts, largely through reduced headcount, does seem to suggest the worst has passed, challenges do remain ahead.

The construction sector's profitability recovered and stabilized in 2015…

On an operational level, the construction sector could see reduced cash flow if plans by the MoF to cut the amount advanced to contractors is implemented. The MoF awards 20 percent of the value of the contract up-font to contractors, but this figure could be reduced going forward. Also, the sector still has the issue of backdated employee pay to be resolved which could impact profitability. Lastly, the sector will continue to be impacted by public investment spending cuts with a risk that a sharp decline in the final quarter of this year in approved projects could occur, much like 2015, resulting in further volatility. On the up side, we expect the sector will benefit from stimulated demand from real estate development due to the imposition of fees on undeveloped land plots. This will incentivize land owners to either develop plots or sell these to developers, helping stimulate private sector construction activity. The sector should also benefit from the expected upcoming construction of residential units as an effort is made to meet the current housing shortage.

...but the sector will have to deal with reduced cash flow, backdated employee payments and lower public investment spending.

On the up side, the sector will benefit from real estate development due to fees on undeveloped land.

The above developments are also likely to support growth in the cement sector which saw sales rise by 8.7 percent in 2015 year-on-year, compared to 2.5 percent in 2014. Record inventory levels and higher energy costs do present challenges to profitability though. Inventory levels of clinker, a binding material used in producing cement, reached more than 100 percent of long term averages at the end of 2015, and this glut is likely to push prices down unless talks of allowing cement exports materialize (Figure 16). Profit margins will also be squeezed by recent energy price reforms instituted by the government across all fuel types. Since the cement sector exhibits

Record inventory levels and higher energy costs do present challenges to profitability in the cement sector…

...with slower growth in sales expected year-on-year.

Hotels in Riyadh and Jeddah saw minimal/ flat growth in occupancy rates in 2015, which pressured average daily rates (ADR).

Competition in these cities is likely to be more common as hotels try to drive up occupancy levels.

The main driver of growth in the sector will of course be religious tourism.

Expansion in the retail sector is expected as the SAGIA moves to allow 100 percent foreign ownership of retail and wholesale businesses.

Growth will also be supported by new retail sites opening up on the outskirts of Jeddah and Riyadh…

high levels of energy intensity, operating costs will rise in the year ahead.

Hotel and Retail:

Growth in profitability in the Saudi hotel sector has been trending downwards in tandem with a slowdown in growth in hotel supply in Jeddah and Riyadh, suggesting the sector is adequately supplied (Figure 17). Both cities saw minimal or flat growth in occupancy rates in 2015, as corporate activity declined in line with slower economic growth, pressuring average daily rates (ADR). Both Riyadh and Jeddah are expected to add a further 13,000 hotel rooms in 2016-17, but we expect a vast majority of these will be cancelled or delayed, which should alleviate some pressure on the sector. Price competition in these cities is likely to be more common as hotels try to drive up occupancy levels, with new entrants likely to cut room rates aggressively in order to win market share.

The main driver of growth in the sector will of course be religious tourism. Both Makkah and Madinah have seen consistent rises in occupancy rates and ADR for a long time and this is expected to continue as both cities see pilgrim visits rising by an annual average of 3-4 percent between 2016-2025.

Most indicators relating to the retail sector, such as profitability and consumer expenditure, whilst remaining positive, showed signs of a slowdown in 2015. One factor contributing to the general slowdown has been negative sentiment associated with lower oil prices and government expenditure as well as the real effects on discretionary spending. Cash withdrawals from ATMs indicated slower growth in consumer spending, up by 7.6 percent year-on-year, compared with 9.7 percent in 2014. Whilst further declines in discretionary spending are expected in 2016 this should be mitigated by a renewed push in Saudization of the labor market, which will help boost spending. This is especially important since Saudis' have a higher expenditure ratio compared to their expatriate counterparts.

Retail sales and profitability will fall in Q1 2016 year-on-year as the sector was one of main beneficiaries of a Royal decree that included a two month salary bonus last year. Aside from that, further expansion in the retail sector is expected as the Saudi Arabian General Investment Authority (SAGIA) moved to allow 100 percent foreign ownership of retail and wholesale business, which will bring

Figure 16: Clinker inventory levels

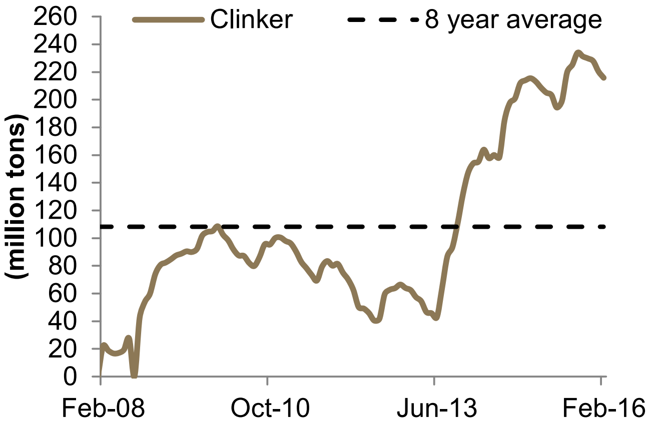
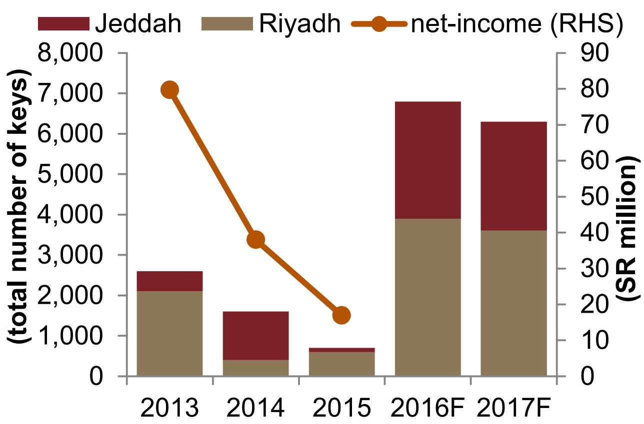


Figure 17: Supply of hotel rooms and net-income of listed hotel companies (year-on-year change)



...which will push down retail rents, thereby lowering operating costs.

in investment. Growth will also be supported by an expanding network of stores across the Kingdom, with new retail sites opening on the outskirts of Jeddah and Riyadh, widening the geographic scope of retail sales. Retail expansion is forecast to add around half a million square meters of leasable retail space in 2016, in both Jeddah and Riyadh, which will push down retail rents, thereby lowering operating costs for the sector.

<u>Other sectors:</u>

Growth in other sectors will be closely related to overall economic activity.

Lower commodities will help the agriculture and food sector…

...but hamper profitability in the industrial investment sector.

Growth in most of the remaining sectors will be closely related to overall economic activity, with a broad slowdown expected, but certain sectors should nevertheless do well. Whilst higher energy costs will add to operational costs in the **agriculture and food** sector, it will benefit from both structural and cyclical factors. A growing population will ensure some level of consumption growth whilst continued lower global commodities prices, which make up around half the sector's cost of goods sold, will ensure margins hold firm. Lower commodities are especially important for the sector since the Kingdom imports around 80 percent of its food requirement. Conversely, lower commodity prices will continue to hamper profitability in the **industrial investment** sector, which saw annual steel production fall by 6.7 percent in 2015. The **energy** sector will benefit from rising electricity consumption, in line with the Electricity and Co-generation Regulatory Authority's (ECRA) forecasts of a 3 percent year-on-year rise in peak load demand. The impact of energy price rises are seen as neutral for the sector since the rise in input costs will be offset by rises in electricity tariffs. The **insurance** sector should benefit from Saudization, as health insurance is increasingly made available for private sector employees, as well as rising vehicle insurance. **Transport** should benefit from more activity in domestic trips as well as a rising number of pilgrims coming into the country, but it will also see higher cost related to fuel price rises.

TASI Outlook

Whilst we believe the TASI is slowly moving towards a more surer footing…

In recent weeks we have seen some tentative signs of recovery in the TASI, and although further volatile trading is likely, we believe the TASI is slowly moving towards a more surer footing. Whilst we do not anticipate a full scale recovery in the near-to-medium term, the current comparatively upbeat situation does present us with an opportunity to be cautiously optimistic as we move forward.

...an important factor determining the TASI's outlook will be clarity in domestic economic policy…

...which makes the announcement of the highly anticipated NTP even more necessary.

Currently, Brent oil prices are trading close to $40 pb, whilst still way below the highs of $100 pb, they represent a significant improvement from lows of $27 pb we saw at the start of the year. Global stock markets have also stabilized as the world wide wobble emanating from concerns over China seem to have now been priced in. Whilst a deterioration in any of the above would negatively impact investor sentiment, we believe an equally important factor determining the TASI's outlook relates to the solid macroeconomic fundamentals of Saudi Arabia. The government has continued supporting economic activity despite the prevailing subdued oil pricing environment and still has ample foreign reserves and debt financing ability to ensure continued to support for the economy. However, we see the absence of clarity on the agenda for economic reform making further sizable gains for the TASI more difficult. This makes the announcement of the highly anticipated NTP even more necessary, as it will reassure investors of the government's commitment towards structural economic reform, helping the private sector to make a more informed and confident decision with respect to investment, which will ultimately help boost corporate activity.

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The data contained in this research is sourced from Thomson Reuters, Institute of International Finance (IIF), OPEC, EIA, Tadawul, Bloomberg, CITC, Ministry of Finance, Al Yamama Cement and JLL.

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